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IN THE

Supreme Court of the United States

October Term, 1938.

No. 169.

THE UNITED STATES,

Petitioner,

v.

FREDERICK PLEASANTS.

On a Writ of Certiorari to the Court of Claims.

Brief as Amicus Curiae in Behalf of
John E. Zimmermann.

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BRIEF OF AMICUS CURIAE IN BEHALF OF
JOHN E. ZIMMERMANN.

PRELIMINARY STATEMENT.

JOHN E. ZIMMERMANN is the Petitioner in the case of Zimmermann v. Commissioner of Internal Revenue, which is presently pending on appeal before the United States Circuit Court of Appeals, Third Circuit, No. 6759, March Term 1938 Sur Petition for Review from the United States Board of Tax Appeals and involves the question of the 15 per cent. limitation prescribed by Section 23 (n) of the Revenue Act of 1932 on the amount allowable as a deduction in computing taxable net income for the contributions made to charitable institutions.

In 1932 Mr. Zimmermann had an ordinary net income of \$129,434.81, exclusive of capital net loss. During this year he made charitable contributions of \$19,122.32, which were less than 15 per cent. of such ordinary net income. The Commissioner originally allowed \$17,178.64 thereof as deductions, but later refused to allow such \$17,178.64 as a deduction in computing tax on such ordinary net income, on the ground that for such year Mr. Zimmermann claimed a capital net loss of \$267,252.87. Accordingly, the Commissioner computed tax on the full \$129,434.81 in the sum of \$45,197.34, allowing a credit against such tax of 12½ per cent. of the capital net loss, or \$33,406.61, resulting in a tax of \$11,632.23, whereas, if the charitable gifts had been allowed as a deduction against ordinary net income, no tax would have been payable.

ARGUMENT.

Where a Taxpayer Has a Net Income on Which He Must Pay an Income Tax, Congress, in Order to Encourage Gifts to Charity, Granted the Privilege of Deducting Such Gifts to the Extent of 15% of Such Taxable Net Income.

Section 23 of the Revenue Act of 1932 (similar to prior Revenue Acts since October 3, 1917) provides that in computing net income there shall be allowed as deductions:

“(n) Charitable and Other Contributions.—In the case of an individual, contributions or gifts made within the taxable year to or for the use of: . . .

“(2) a corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary or educational purposes, . . . to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection . . . ”

This Court, in *Helvering v. Bliss*, 293 U. S. 144, at p. 147, recognized that Congress intended by this section to encourage gifts to religious, educational and other charitable objects and stated:

“Nor should the reduction in the rate of tax on capital gain first granted in the Revenue Act of 1921 be held to circumscribe the privilege granted in the earlier acts and retained in later ones with respect to charitable contributions unless that result be plainly required by the language used.”

Similarly, the provisions, first appearing in the Revenue Act of 1924, limiting the extent to which capital net

losses (12½% thereof) could be used to reduce the total tax liability, should not be construed to deny to a taxpayer sustaining a capital net loss, the deduction for contributions which Congress admittedly intended to encourage.

This, however, is the precise effect of the Government's interpretation of the statute. Mr. Zimmerman, during 1932 had made contributions to charities amounting to \$17,178.64, and in the same year suffered a capital net loss of \$267,252.87, and had a net income, before deducting gifts to charities, of \$129,434.81.

Under the Commissioner's theory, which we submit is erroneous, he construes the law as requiring the following computation of taxable net income and tax:

COMMISSIONER'S COMPUTATION.

Income

Net Income (before deduction of contributions)	\$129,434.81
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Deductions

Capital Net Loss	\$267,252.87	
Contributions (allowable)	None	— 267,252.87

Net Income (none)	Net loss	—\$137,818.06
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Therefore he allows no deduction for contributions.

Now, to find the Net Income on which he computes tax, he adds back the Capital Net loss of

	+ \$267,252.87
resulting in Ordinary Net Income of	129,434.81

Argument

5

The normal tax and surtax imposed by Sections 11 and 12 on \$129,252.87 (less \$158.50 credit for tax paid at source) is	\$45,038.84
minus credit 12½% of Capital Net Loss of \$267,252.87 or—	33,406.61
	<hr/>

Total Tax determined by Commissioner—	\$11,632.23
	<hr/> <hr/>

The Commissioner thus levies a tax of \$11,632.23 despite his finding that the taxpayer had no net income.

It is respectfully submitted that no such construction was ever intended by Congress nor can it be found in the Act. There is no provision of the law that requires a Capital Net Loss to be deducted in computing the Net Income on which the 15 per cent. allowance for contributions is to be made and then, after determining the deduction or contributions, to add back to the net result the Capital Net Loss. The effect of the Commissioner's theory as shown by the above computation is that he levies a tax on the Capital Net Loss and then reduces the tax by 12½ per cent. of the Capital Net Loss to determine the Total Tax payable.

We submit that a correct construction of the law requires the computation to be made in the following manner:

INCOME

Net Income (before deduction of contributions)	\$ 129,434.81
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DEDUCTIONS

Contributions (not more than 15% of net income of \$129,252.87)	17,178.64
	<hr/>

Ordinary Taxable Net Income	\$ 112,256.17
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The tax imposed by Sections 11 and 12 on \$112,256.17 (less \$158.50 credit for tax paid at source)	34,259.94
Minus credit 12½% of Capital Net Loss of \$267,252.87	33,406.61

The total tax determined under Section
101 (b) to be collected and paid
under Section 101 (d) is \$ 1,853.33

The Term "Net Income," as Used in Sec. 23 (n) of the Revenue Act of 1932 Granting a Taxpayer a Deduction for Contributions to Charities Means the Taxable Net Income Exclusive of Capital Net Loss and Does Not Mean That Net Income Minus Deduction for Capital Net Loss.

Under the Revenue Act a taxpayer with a net income of over \$16,000 who has sustained a capital net loss must compute his taxable net income and is taxed thereon under Sections 101 (b) (c) and (d). He has no such election as is given under Section 101 (a) to a taxpayer who has a capital net gain.

This construction is supported by the language of Section 12 (c) which, while not a substantive provision, nevertheless indicates clearly the meaning which Congress intended to give to "net income" in cases involving capital losses.

"(c) Capital Net Gains and Losses.—For rate and computation of tax in lieu of normal and surtax . . . in case of net incomes, excluding items of capital gain, capital loss, and capital deductions of not less than \$16,000, approximately, see Section 101."

The language of Section 101 (b) is perfectly explicit:

“(b) *Tax in Case of Capital Net Loss.*—In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there shall be levied, collected and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a *partial tax* shall first be computed upon the basis of the *ordinary net income* at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus $12\frac{1}{2}$ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.” (Italics supplied.)

By Section 101 (c) (7), *ordinary net income* is defined as follows:

“(7) ‘*Ordinary net income*’ means the net income computed in accordance with the provisions of this title, after *excluding all items* of capital gain, capital loss, and capital deductions.” (Italics supplied.)

By this explicit language, in computing “ordinary net income” capital losses are excluded. In case of a taxpayer with a salary of \$20,000, and capital losses of \$20,000, his “ordinary net income,” on which the partial tax is to be computed under the above formula, certainly is \$20,000, because it is expressly provided that his \$20,000 capital net loss is excluded. In making such partial computation, his deduction for charitable contributions must therefore be figured on the basis of this \$20,000 income without deduction for the \$20,000 capital losses, which Section 101 (b) and (c) (7) expressly requires to be excluded.

Having computed the partial tax on the above basis, Sec. 101 (b) provides that, from the amount of tax thus ascertained, there shall be deducted $12\frac{1}{2}$ per cent. of the \$20,000 capital net loss.

The language of the statute is explicit. To sustain the Commissioner's contention, this explicit language must be arbitrarily disregard, for the purpose, not of giving the benefit of the doubt in favor of the taxpayer, but of imposing an additional tax not called for by the words of the statute or consistent with its object; with the result, not of encouraging gifts to charity, but of manifestly discouraging them.

The construction of the statute contended for by the taxpayer in this case is entirely in harmony with the decision of this Court in the case of *Helvering v. Bliss*, supra.

The decision in the *Bliss* case was based on the principle that the Act is to be construed so as to promote the obvious purpose to encourage gifts to charity, and, in case of doubt, in favor of the taxpayer:

"If the meaning of the Act were doubtful, we should still reach the same conclusion. The exemption of income devoted to charity and the reduction of the rate of tax on capital gains were liberalizations of the law in the taxpayer's favor, were begotten from motives of public policy, and are not to be narrowly construed."

The manifest unreasonableness and unfairness of the construction of the Act advocated by the Commissioner is apparent when one considers the practical manner in which charitable contributions are made.

A taxpayer with a large salary or income from investments can, at the beginning of the year, estimate, with rea-

reasonable accuracy, the amount of his income. The Government, in the tax law, tells him that, to the extent of 15 per cent. of his ordinary income, he may deduct charitable contributions in figuring income tax.

The solicitation of charitable contributions is not confined to the last months of the year, but goes on throughout the year; and such contributions must be made from time to time.

Capital losses may, however, occur at any time throughout the year, including the end of the year.

It is manifestly unfair that a taxpayer who has fixed the amount of its charitable contributions on the basis of the deductibility of a certain percent. in computing income tax, should be denied such right of deduction because of tax losses late in the year which have rendered him even less able to afford the contributions.

If a taxpayer realizes large capital gains toward the end of the year, he still has time to make additional contributions which he can then afford. He cannot, however, after incurring capital losses, take back contributions which he has already made.

A totally unfair and unreasonable result of applying the Commissioner's interpretation to the statute is also seen by examining Section 120 which provides that, where a taxpayer, for the current taxable year and in each of the preceding ten years, has given over 90 per cent. of his net income (after deducting income, war profits, and excess profits taxes paid) to charity, there shall be no limitation on the deduction of such contributions.

Assume that in a taxable year taxpayers A and B each had \$300,000 taxable net profit from business and \$300,000 of capital net losses, and each contributed in that year

\$270,000 to charity. Taxpayer A, however, had contributed over 90 per cent. of his income for the past ten years, but taxpayer B had, for the first time, determined to emulate taxpayer A's example and duplicate his gifts to charity. Under the Commissioner's construction, *supra*, taxpayer A would be entitled to deduct the entire \$270,000 of contributions, but taxpayer B, who, of course, may not deduct the entire \$270,000 of contributions, since he has not fulfilled the ten-year requirement, is denied by the Commissioner even the 15 per cent. deduction provided by Section 23 (n). It is respectfully submitted that Congress never intended such a result, nor is it required by the explicit wording of the statute, as is pointed out *supra*.

We submit that the decision below, *Pleasants v. United States*, 22 F. Supp. 964, is a correct interpretation of the statute and should be affirmed.

Respectfully submitted,

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SUPREME COURT OF THE UNITED STATES.

No. 169.—OCTOBER TERM, 1938.

The United States, Petitioner, }
vs. } On Writ of Certiorari to the
Frédéric Pleasants. } Court of Claims.

[January 3, 1939.]

Mr. Chief Justice HUGHES delivered the opinion of the Court.

The question is whether the 15 per centum allowed as a deduction for charitable contributions under Section 23(n) of the Revenue Act of 1932 is to be calculated on the taxpayer's net income computed without regard to a capital net loss as to which special provision is made by Section 101(b).

Section 23(n) provides that in computing net income there shall be allowed as a deduction from gross income—

"In the case of an individual, contributions or gifts made within the taxable year to or for the use of: . . . to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection"

Respondent in 1932 made charitable contributions to the amount of \$3496. His net income, irrespective of a capital net loss, was determined by the Commissioner to be \$94,963.52. Upon that net income the Commissioner assessed the normal tax and surtax at the rates prescribed by Sections 11 and 12.¹ Respondent contended that this was his net income as described in Section 23(n) and that as his charitable contributions were less than 15 per centum of that

¹ These sections provide:

"Sec. 11. *Normal Tax on Individuals.*—

"There shall be levied, collected and paid for each taxable year upon the net income of every individual a normal tax equal to the sum of the following:

"Sec. 12. *Surtax on Individuals.*—

"(a) *Rates of Surtax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every individual a surtax as follows:

amount they were deductible in full in determining his normal tax and surtax. The Commissioner refused to allow the deduction.

The taxpayer had sustained a "capital net loss", as defined in Section 101(c) (6), of \$154,921.98. The Commissioner ruled that "Since the capital loss of \$154,921.98 is in excess of adjusted ordinary net income of \$94,963.52 (without contributions) there is no net income against which to make a deduction for contributions".

Having paid the tax assessed by the Commissioner upon that theory, respondent filed his claim for a refund and on its rejection brought this suit in the Court of Claims. Judgment was rendered in his favor. 22 F. Supp. 964. Because of an asserted conflict with decisions of Circuit Courts of Appeals² and with our ruling in *Helvering v. Bliss*, 293 U. S. 144, certiorari was granted. October 10, 1938.

"Capital net gains" and "capital net losses" of individual taxpayers are the subject of special treatment under Section 101. In the case of a "capital net gain", there is to be levied, at the election of the taxpayer, and in lieu of all other taxes imposed by the income tax title, a tax of 12½ per centum of the capital net gain, to be added to the tax computed upon the basis of the "ordinary net income". Sec. 101(a). In the case of a "capital net loss", Section 101(b) provides for a tax to be determined, also in lieu of other income taxes but irrespective of any election by the taxpayer, as follows:

"a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section".

Section 101(c) (6) defines "capital net loss" as "the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain". Section 101(c) (7) defines "ordinary net income" as "the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions".

There is no doubt as to the purpose of this provision as to capital net losses which was first introduced in the Revenue Act of 1924.³

² *Avery v. Commissioner*, C. C. A. 7th, 84 F. (2d) 905; *Lockhart v. Commissioner*, C. C. A. 3d, 89 F. (2d) 143; *Heinz v. Commissioner*, C. C. A. 3d, 94 F. (2d) 832.

³ Revenue Act of 1924, Sec. 208(c).

Prior to that time, and under the Revenue Act of 1921, capital losses were to be deducted from capital gains in the process of determining the "capital net gain".⁴ If capital deductions and capital losses were in excess of the capital gain, or if there were capital losses in the absence of capital gain, such losses were deductible as ordinary losses. We are told that the opportunity to minimize taxes by the practice of taking capital losses to offset ordinary net income constituted a particularly serious problem after the Act of 1921, which reduced the rate of tax on capital net gains. The results to the Treasury of that method of treating capital losses led to the adoption in the Act of 1924 of the plan for subjecting capital net losses to a limited rate in order to protect the revenues,⁵ a plan which was continued in the Revenue Acts of 1926, 1928 and 1932.⁶

It will be observed that the provision for the limitation with respect to a capital net loss under Section 101(b) (unlike the provision in Section 101(a) as to a capital net gain) gives no option to the taxpayer.⁷ The limitation is explicit and must be followed as written. The limitation applies equally when there is no capital gain and hence nothing to be deducted from capital losses on that score.⁸ The limitation is applicable unless, as stated in the last clause of Section 101(b), a greater tax would result from not applying it.⁹ In the instant case there is no question that the limitation does apply and the Commissioner has applied it.

In such a case the statute directs that a partial tax shall be first computed upon the basis of the "ordinary net income" and at the rates and in the manner provided in Sections 11 and 12.¹⁰ The total tax is then arrived at by deducting 12½ per centum of the capital net loss. That loss thus figures in the computation of the total tax only by the allowance of an offset to the specified extent against the tax determined apart from the capital losses. Thus where the limitation is applicable and the offset of 12½ per centum of the capital net loss is allowed accordingly, capital losses are not deductible in determining the taxpayer's net income for the pur-

⁴ Revenue Act of 1921, Sec. 206(a) (4).

⁵ *Piper v. Willcuts*, 64 F. (2d) 813, 816; 65th Cong. Rec. 2428; H. Rep. 179, 68th Cong., 1st sess., p. 20.

⁶ Revenue Act of 1926, Sec. 206(c); 1928, Sec. 101(b); 1932, Sec. 101(b).

⁷ Regulations 77, Art. 503.

⁸ See *Piper v. Willcuts*, 64 F. (2d) 813, 816; *Hoffman v. Commissioner*, 71 F. (2d) 929.

⁹ See illustration in Regulations 77, Art. 503.

¹⁰ See Note 1.

pose of the normal tax and surtax. And, as in such case there is no capital gain, the "ordinary net income" under Section 101(b), that is, the net income computed after excluding capital loss and capital deductions, is the only net income upon which a tax is laid.

We have noted that the limitation of Section 101(b) is not applicable if the tax, computed without regard to that section, would be greater. The latter method of computation brings out the distinction clearly. For in that method the capital net loss is deducted from the ordinary net income in order to arrive at the total net income for the purpose of applying the normal tax and surtax rates. See illustration in Regulations 77, Article 503. But where the limitation of Section 101(b) governs, because the tax as otherwise computed would not be greater, capital losses are not deducted in determining the net income which is to be taxed, but are used only for the purpose of determining the specified offset against the tax on that net income. *Id.*

We are not impressed with the argument based on the provisions of Sections 21, 22 and 23. True, Section 21 provides that "net income" means gross income computed under Section 22 less the deductions allowed by Section 23. Section 22 defines gross income and Section 23 provides for deductions, including deductions for losses. But Sections 21, 22 and 23 are not to be construed so as to derogate from the special and explicit provisions of Section 101(b). Under the limitation of that section, as we have seen, the taxpayer is not permitted to deduct capital losses so as to reduce the net income subject to tax and his capital losses enter into the computation of his ultimate tax only through the deduction of 12½ per centum of the capital net loss from the tax which is computed upon the net income ascertained irrespective of that loss.

It is in this light that we must decide the particular question here presented as to the meaning of the words "the taxpayer's net income" in Section 23(n) providing for a deduction of 15 per centum for charitable contributions. Do these words refer to the taxpayer's net income which under the statutory scheme is actually subject to tax? Or is that net income, although treated as subsisting for the purpose of being taxed, to be regarded as non-existent for the purpose of admitting deductions for contributions? We think that Congress, in the application of the special provision of Section 101(b) for an offset in case of a capital net loss intended to make the taxpayer's net income, ascertained irrespec-

tive of that loss, the subject of the tax and that the provision in Section 21(n) allowing a deduction for charitable contributions is applicable to that taxable net income.

There is nothing to the contrary in our decision in *Helvering v. Bliss*, *supra*. In that case there was a capital net gain. The net income of the taxpayer comprehended that net gain as well as his net income otherwise computed. We decided that it was his total net income which was to be regarded as the basis for the allowance under Section 23(n). We found nothing in Section 101, which in that application prescribed "merely a method for segregating a portion of that net income for taxation at a special rate", that in any wise altered the right of the taxpayer to take the deduction in accordance with Section 23(n). *Id.*, 150, 151. Here, instead of a capital net gain, we have a capital net loss. There is no gain to be added to the taxpayer's net income otherwise computed, and thus that is the only net income taxable under the statute. To that net income, the provision of Section 23(n) appropriately applies. We observed in the *Bliss* case that the exemption of income devoted to charity and the reduction of the rate of tax on capital gains "were liberalizations of the law in the taxpayer's favor, were begotten from motives of public policy, and are not to be narrowly construed". That observation is equally pertinent here.

The administrative construction invoked by the Government has not been of a sufficiently consistent character to afford adequate support for its contention.¹¹

We conclude that the Commissioner erred in refusing to permit the deduction sought by respondent for his charitable contributions and that the judgment of the Court of Claims should be affirmed.

Affirmed.

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Test :

Clerk, Supreme Court, U. S.

¹¹ See I. T. 2104, III-2 Cum. Bull. 152; *Elkins v. Commissioner*, 24 B. T. A. 572; *Livingood v. Commissioner*, 25 B. T. A. 585, 589; XI-1 Cum. Bull. 9, 33; XI-2 Cum. Bull. 3, 6, 29, 268; *Strans v. Commissioner*, 27 B. T. A. 1116; XIII-2 Cum. Bull. 25, 29, 135.